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UNCLAS SECTION 01 OF 02 COLOMBO 000424

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SUBJECT: SRI LANKAN REQUEST FOR POST TSUNAMI DEBT RELIEF

1. On February 24, Post received a letter from Finance Minister Sarath Amunagama addressed to US Treasurer Anna Escobedo Cabral (unclear why Cabral was addressee). The original is to be sent directly to Treasury by the Sri Lankan Embassy in Washington. The letter (text below) repeats Amunagama's February 17 letter to the Paris Club almost verbatim. It outlines damage to Sri Lanka as a result of the tsunami, expounds on Sri Lanka's relief and reconstruction needs and requests a debt deferment of 3-5 years.

2. Post has, in response to other queries, already discussed debt relief with the GSL and explained that since Sri Lanka does not have an active IMF program, a one year deferral, followed by a four year restructuring would likely be the best we could offer.

3. Begin Text of Finance Minister's Letter:

Ms. Anna Escobedo Cabral
US Treasurer
1500 Pennsylvania Ave
NW Washington DC 20220
USA

Dear Madam,

REQUEST FOR DEBT RELIEF AS BUDGETARY AND BALANCE OF PAYMENTS
SUPPORT FOR POST-TSUNAMI RELIEF, REHABILITATION AND
RECONSTRUCTION (RRR)

The Tsunami disaster on 26th of December took away the lives of over 30,000 in Sri Lanka, made nearly one million persons homeless and caused extensive damage to private and public property and infrastructure in the affected areas in the coastal belt. The asset loss alone is estimated at least around US\$ 900 million (slightly over 4% of GDP). Our latest assessment suggests that the total reconstruction expenditure is around USD 1.5 billion particularly in view of the fact that the reconstruction process should avoid vulnerabilities to natural hazards in the future. The underlying strategy has been a multi-hazard risk approach during the recovery phase to ensure that communities and assets are less vulnerable to impact of future disasters. The bulk of this expenditure is on housing and townships, transportation infrastructure, including roads, railways, and ports (USD 400 million), the fisheries sector infrastructure requirements such as harbours, anchorages and related facilities (USD 200 million), water supply and sanitation projects (USD 150 million) and schools and hospitals building (USD 120 million). In our reconstruction and recovery program which will take around 2-3 years, provisions will also be made to the coast conservation and natural resources affections as well. Substantial work has to be done in these areas.

To meet the urgent needs of those affected, the response of the government has been swift and comprehensive, supported by the assistance of donors and relief agencies. While immediate efforts have focused on the humanitarian needs of the survivors, we also aim to undertake as much as 40 percent of the required rehabilitation and reconstruction in 2005 with particular emphasis on settlements and livelihood support. With the generous support of international donors, we aim to undertake this work without jeopardizing macroeconomic stability.

The government's immediate policy response includes several initiatives to meet the humanitarian needs of the people while also safeguarding key macroeconomic objectives. These include: (i) immediate humanitarian support to affected individuals amounting to an estimated 0.2 percent of GDP this year; (ii) a concessional refinancing scheme to ensure that funding is available for small and medium enterprises, initially set at Rs 5 billion; and (iii) measures to ensure availability of liquidity and smooth functioning of payments and settlements system.

The overall negative impact on GDP growth will be limited by the initiation of rehabilitation and reconstruction. However, this will lead to significant additional government expenditure in 2005. We estimate that the total fiscal cost in 2005 to be about 2 percent of GDP, with most of this

reflected in development expenditure. While there could be some minor revenue shortfalls in some areas, we expect these to be limited to about 1/4 percent of GDP. This will push the fiscal deficit this year to about 9 3/4 percent of GDP compared to the 7 1/2 percent envisaged in the 2005 budget. The government expects to meet the additional expenditure on account of post Tsunami relief, rehabilitation and reconstruction programme out of donor assistance. Additionally, external debt relief would help the government to provide fiscal space to accommodate reconstruction expenditure while containing domestic financing, making more resources available to the private sector. The country's resources have also been under severe strain due to other external shocks namely the higher oil prices and a severe drought in early 200. Heavy foreign debt service payments amounting to USD 550 million also exerted pressure on the limited foreign reserves. The 2004 has ended up with a balance of payments deficit of USD 212 million and gross official reserves have depleted by USD 322 to USD 1,718 million at end 2004. The official foreign loans amortization alone, excluding the debt service payments to IMF, for which we have got some relief, in 2005-2008 amounting to USD 2,241 is a heavy burden on the budget and the balance of payments. The balance of payments pressures due to high oil prices too is likely to continue. Given this resource constraint it is only with the assurance of enhanced generous budgetary and balance of payments support from the donor community at highly concessional terms, including debt relief that the urgent and massive task of RRR (note: relief, rehabilitation and reconstruction. Endnote) can be effectively undertaken without undermining the development work of the rest of the country.

In this background, the announcement of debt relief by your Government would provide us a great encouragement. Therefore, we shall be grateful if you could differ (sic - should read defer) the debt service payments for a period of 3-5 years during which time we expect to complete the reconstruction work of the affected region. Such relief will enable us to finance the required counterpart expenses of donor funded project and will provide us the much needed fiscal and balance of payments space to manage the challenges ahead.

We greatly appreciate your assistance and cooperation in this regard.

Yours sincerely

Sarath L B Amunagama
Minister of Finance & Planning

End text.

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